Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1970

NO. 373

In the Matter of
CARNELL CONSTRUCTION CORP., a corporation of the State of New York, authorized to do business in the State of New Jersey

JAMES E. MASTERSON,
Receiver-Petitioner,

vs.

VALLEY NATIONAL BANK OF LONG ISLAND,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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TO THE HONORABLE THE CHIEF JUSTICE AND ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

Your Petitioner, CARNELL CONSTRUCTION CORP., respectfully prays that a Writ of Certiorari issue to review the decision of the United States Court of Appeals for the Third Circuit in an Opinion (annexed hereto) per McLaughlin, J.

The Opinion of the United States District Court for the District of New Jersey is not reported.

The decision of the United States Court of Appeals for the Third Circuit is reported at 424 F. 2d 296.

The Judgment sought to be reviewed is dated April 10, 1970, and was entered on the same date.

Jurisdiction

The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

Question Presented

Does the Bankruptcy Act confer summary jurisdiction on a Court of Bankruptcy to compel a creditor who has filed a claim in the bankruptcy proceedings to surrender a voidable preference or improper set-off, whether or not the preference or set-off relates to the same transaction as the creditor's claim?

Statute Involved

This case involves 11 U.S.C. 93(g), which provides as follows:

> "(g) No claims of creditors who have received or acquired preferences, liens, conveyances, transfers, assignments, or encumbrances, void or voidable under this title, shall not be allowed unless such creditors shall surrender such preferences, liens, conveyances, transfers, assignment, or encumbrances."

Statement of Case

On May 31, 1967, Carnell Construction Corp. (hereinafter "Carnell") filed a Petition in the United States District Court for the District of New Jersey seeking to effect an arrangement with its creditors pursuant to Chapter XI of the National Bankruptcy Act. Prior to such filing, the Valley National Bank of Long Island (hereinafter "Bank") held a security interest in 2 Cadillac automobiles owned by and in possession of Carnell. On March 28, 1968, the Bank filed a Proof of Claim with the Clerk of the Bankruptcy Court in which it asserted a balance due on the 2 automobiles in the sum of $5,628.27. In addition to that automobile financing, as of March 1, 1967, Carnell owed the Bank $85,000.00 on outstanding loan. As of March 1, 1967, Carnell was a member of a joint venture which owned a Certificate of Deposit issued by the Bank in the name of the joint venture in an amount exceeding $85,000.00. When the joint venture surrendered the Certificate for redemption, the Bank applied $85,000.00 of the proceeds of the redemption in liquidation of the $85,000.00 owed to the Bank by Carnell and paid the balance of the proceeds to the joint venture.

In response to the Proof of Claim filed by the Bank, the Receiver filed a Petition in the Bankruptcy Court alleging that the Bank's self-help, above described, resulted in a voidable preference or an unlawful set-off, upon which grounds the Receiver objected to the allowance of the claim and counterclaimed for an Order directing the Bank to pay over to the Receiver $85,000.00 plus interest thereon from March 1, 1967. Although the Counterclaim was concededly unrelated to the claim which the Bank alleged in its Proof of Claim, the Receiver asserted as a basis for the Bankruptcy Court's summary jurisdiction the proposition

that the Bankruptcy Court had summary jurisdiction to affirmatively order a claimant to surrender preferences or set-offs whenever Section 57(g) would require disallowance of the claim, and, further, that 57(g) requires disallowance, whether the preference or set-off is related or not. The Referee concluded that such jurisdiction existed and ordered a hearing on the merits. Before the date of such hearing, the Bank brought the issue to the District Court by Petition for Review. The District Court held that the Bankruptcy Court had no jurisdiction over the unrelated Counterclaim of the Receiver and reversed the conclusion of the Bankruptcy Court by Judgment dated May 9, 1969.

On June 4, 1969, the Receiver filed Notice of Appeal to the Court of Appeals for the Third Circuit which affirmed the Judgment of the District Court on April 10, 1970.

Reasons for Granting of Writ

1. The decision of the Court of Appeals below is in direct conflict with 2 decisions of the Court of Appeals for the Tenth Circuit.

2. The decision of the Court of Appeals below decides a question important to the administration of Bankruptcy law which this court commented upon but specifically passed in *Katchen vs. Landy*, 382 U.S. 323, 15 F. 2d 391, 86 Sup. Ct. 467 (1966). The importance of a decision by this Court on that question is underscored by conflict between the Circuits.

3. The decision of the Court of Appeals below interprets Section 57(g) in a way which conflicts with this Court's interpretation of said Section as discussed in *Katchen, supra.*

Reason 1. The Court of Appeals below held that the Bankruptcy Court does not have summary jurisdiction of a Counterclaim by a Receiver in Bankruptcy unless the Counterclaim is related to the subject matter of the Proof of Claim filed by the creditor. Its decision treats as irrelevant the question of whether or not the subject matter of the Counterclaim is a preference which under 57(g) would require disallowance of the Proof of Claim. This holding is in direct conflict with *Inter-State vs. Luther*, 221 F. 2d 382 (CCA 10) and *Katchen vs. Landy*, 336 F. 2d 535 (CCA 10). In the latter decision, speaking of *Inter-State*, the Tenth Circuit said:

> "In Inter-State, we upheld the power of the Bankruptcy Court to entertain a Counterclaim to fully adjudicate and recover a Sec. 57, sub. g preference, whether such Counterclaim is compulsory under Rule 13(a) or permissive under Rule 13(b), F.R. Civ. P." 336 F. 2d at 536.

The Court of Appeals for the Tenth Circuit in *Katchen* further said:

> "Upon reconsideration of Inter-State, in the light of subsequent decisions and commentary, we have decided to adhere to its pronouncements. But, we decline to extend the summary jurisdiction of the Court by implied consent to Counterclaims which do not involve a preference, set-off, voidable lien, or a fraudulent transfer, and which are wholly unrelated to the creditor's claim." 336 F. 2d at 537.

In footnote 1 of its opinion in *Katchen*, this court noted the direct conflict between the decision of the Tenth Circuit in *Katchen* and former decisions on the same point in the Fifth and Third Circuits.

Reasons 2 and 3. As this court indicated in footnote 5 to its Opinion in *Katchen*, the exact reach of 57(g) is not

entirely settled. The decision below implicates not only the "question presented" here but also the subsidiary question of whether or not all 57(g) objections to a Proof of Claim are to be summarily determined, whether the subject matter is related to the claim or not. The author of the opinion in this court in *Katchen* in footnote 5, indicated that 57(g) "contemplates that allowance of a claim may be conditioned on surrender of preferences received with respect to transactions unrelated to the claims." The Court of Appeals below has in effect ruled to the contrary. The exact reach of 57(g), in terms of reference of this point is of obvious basic importance in the administration of Bankruptcy estates. Since this case squarely presents that question, it is respectfully urged that the question should be taken by this court.

In each of the 3 courts which have dealt with this litigation, the sole issue framed, briefed, and argued, was the issue of jurisdiction. However, the Court of Appeals below, in the last paragraph of its opinion, dealt with the merits of the Receiver's Counterclaim and said:

> "... it is obvious that the Bank's set-off of Carnell's deposit to the amount of Carnell's indebtedness to the Bank was not a preference since under Section 68 of the Bankruptcy Act as construed by the decisional law the Bank had the right to make the set-off."

In using the phrase "Carnell's deposit", the Court of Appeals was mistaken. The deposit was owned by a joint venture which was not in a debtor-creditor relationship with the Bank and its deposit was therefore not properly subject to set-off. 4 Collier on Bankruptcy, Section 68.04 (2.2) page 876 (14th ed.); *Gray vs. Rollo*, 18 Wall 629, 21 L. Ed. 927.

The question involved in this case is of equal importance with the question involved and taken for decision by this Court in *Katchen*. It would be unfortunate if this Court should refuse the present question because of a fundamental error as to the facts upon which the merits would ultimately turn.

CONCLUSION

For the reasons assigned, it is respectfully submitted that this Court should grant the Writ of Certiorari to the Petitioner.

Respectfully submitted,

Jack L. Cohen /s/
JACK L. COHEN
Attorney for Petitioner

ADDENDUM A

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW JERSEY

In Bankruptcy No. B-789-67

In the Matter of

CARNELL CONSTRUCTION CORP.,

Debtor.

ON PETITION OF RECEIVER FOR TURNOVER OF FUNDS FROM VALLEY NATIONAL BANK OF LONG ISLAND

Opinion and Order
(Filed Sept. 22, 1968)

Appearances:

Jack L. Cohen, Esquire
Newark, New Jersey
Attorney for Receiver, James E. Masterson

Mullooly, Jeffrey & Rooney, Esquires
Garden City, New York and
Ravin and Ravin, Esquires, Newark, New Jersey
Attorneys for Valley National Bank of
Long Island

LIPKIN, Referee

The Carnell Construction Corp. is before this Court under the provisions of Chapter XI of the Bankruptcy Act whereby it seeks to ultimately effect a Plan of Arrangement.

One of the creditors, Valley National Bank of Long Island (Bank), has filed a proof of claim wherein it claims due it the sum of $5,628.67, secured by liens on two 1966 Cadillacs.

The Receiver subsequently filed a Petition and Order to Show Cause directed against the Bank wherein he seeks an Order to compel the Bank to turn over to him the sum of $85,000.00 which he alleges was appropriated by the Bank without right to do so.

The Bank has filed a Special Appearance wherein it alleges this Court lacks jurisdiction in the turnover proceeding of the person of the Bank and also of the subject matter of its claim as foreign to the subject matter of the turnover proceeding. It seeks to have this Court relegate the Receiver to a plenary action in another Court.

The Bank relies heavily on *Gill v. Phillips*, 337 F. 2d 258 (5th Cir. 1964) and cases of similar import such as *In re Industrial Associates, Inc.*, 155 F. Supp. 866 (E.D. of Pa. 1957) in asserting its contention that the filing of a claim does not confer jurisdiction on the bankruptcy court to hear a counterclaim. That question was answered conversely to the Bank's allegation by the Supreme Court of the United States in its decision of *Katchen v. Landy*, 86 S. Ct. 467, 382 U.S. 323, (1/17/66). Prior thereto there were contrary decisions among the Circuit Court of Appeals. The Third Circuit in the case of *In re Solar Mfg. Corp.*, 200 F. 2nd 327, (1952) had held a trustee could counterclaim in the Bankruptcy Court. The question has now been resolved by the Supreme Court whereby a trustee may file a counterclaim when a creditor files a claim.

The Bank also alleges that it had to file a claim under the provisions of Section 355 of the Bankruptcy Act, because it therein calls for application of Section 57(n) of the Act. That is not so. The Bank alleges it had to file

a claim as a secured creditor. That is not so. A secured creditor if it has possession of the security "may disregard the bankruptcy proceedings and decline to file a claim and rely solely upon his security". *U.S. Bank v. Chase Bank*, 331 U.S. 28, 33, 67 S. Ct. 1041, 91 L. Ed. 132. Only if the security is within the jurisdiction of the Bankruptcy Court and the creditor wishes to retain his secured status must the creditor file his secured claim, as the Bankruptcy Court has exclusive jurisdiction over the liquidation of the security. *Isaacs v. Hobbs Tie and Timber Co.*, 282 U.S. 734. *Oppenheimer v. Oldham*, 178 F. 2nd 386 (5th Cir. 1949). Only in the event the Receiver or Debtor had by Petition compelled the creditor to prove the amount and validity of its debt should the Bankruptcy Court recognize the right of the creditor to assert an adverse claim to property in a plenary suit in another forum. But once the creditor files a claim, then he submits to the jurisdiction of the court and a counterclaim may be filed to the claim. *Katchen v. Landy, supra.* (Note: Section 355 was amended November 28, 1967 whereby claims shall be filed before confirmation or within thirty days after confirmation but the amendment does not compel filing a claim.)

The fact that the proceedings before me arose under the provisions of Chapter XI and not straight bankruptcy does not improve the Bank's position. The Bankruptcy Act, Section 302, (11 U.S.C. 702) provides that Chapter I to VII inclusive of the Act, where not inconsistent with Chapter XI provisions of the Act, shall apply to Chapter XI. Provisions relating to bankrupts shall be deemed to relate to debtors and bankruptcy proceedings or proceedings in bankruptcy shall be deemed to include proceedings under Chapter XI.

The Bank in its brief also relies on several cases which originated from Petitions filed by the trustee for a turnover

order. *In Re H. L. Gentry Const. Co.*, 200 F. Supp. 546, aff'd. 314 F. 2d 945, *Slenderella Systems of Berkeley v. Pacific Tel. & Tel. Co.*, 286 F. 2d 488. In those cases, the creditor had not submitted to the jurisdiction of the court through the filing of a claim and the respondents named in the Petition had a right to stay out of the Bankruptcy Court if they so desired. However these cases are inopposite to the matter now before this Court because in this case the Bank did file a claim. Its claim having been filed, the Debtor or the Receiver could attack its validity or the amount due and void such claims if creditors refuse to return invalid liens or preferences. *Section 57(g) Bankruptcy Act* (11 U.S.C. 93).

Also, viewing the other side of the coin, the creditor having filed its claim could have this court determine the value of the security and if the security was not sufficient to pay the debt which it secured, then the court could allow an unsecured claim in favor of the creditor for the deficiency. *Section 57(h) Bankruptcy Act* (11 U.S.C. 93).

The Bank also relies heavily in its special appearance wherein it denies jurisdiction in this Court to hear the matter upon the provisions of Section 94, 12 U.S.C. This section provides that actions and proceedings against a National Bank "may be had in any district or Territorial court of the United States held within the district in which such association may be established, or in any State, county or municipal court in the county or city in which said association is located having jurisdiction in similar cases." Bank is a national bank with its head office in Nassau County, New York which is in the Eastern District of New York. To a point the position of the Bank is correct that it can only be sued in the District, County or City where located. *Mercantile National Bank at Dallas v. Langdeau*, 371 U.S. 555 (1962). However under the

Statute giving the Bank its powers it has the power "Fourth To sue and be sued, complain and defend, in any court of law and equity, as fully as natural persons." 12 U.S.C. 24. Clearly if it brings suit as a national person in a court located at a place other than its own place of business it may be subject to a cross suit or counterclaim. It would be anomalous to permit a National Bank to bring suit in a foreign jurisdiction and yet not account to that court for its actions. Section 94 above is not an absolute prohibition of a trial against a National Bank except at its home base but at best created a personal privilege of exemption from such suits and that personal privilege could be waived. *Charlotte National Bank v. Morgan*, 132 U.S. 141. That case is even stronger than the matter presently before me. There the bank was sued and did not object at the time of the trial to the location of the suit and raised it only on appeal. The court held the privilege of exemption from suit had been waived. In this case the Bank has filed its claim in this Court and under *Katchen v. Landy* has thereby submitted to the jurisdiction of this Court.

I am not, in disposing of the present questions, passing upon the merits of the claims between the parties. The question of set-offs and counterclaims is a matter to be decided only after proofs are offered, recognizing the rights of bankrupts or debtors and creditors to have such matters determined in accordance with *Section 68 of the Bankruptcy Act* (11 U.S.C. 108).

William Lipkin /s/
WILLIAM LIPKIN
Referee in Bankruptcy

Dated at Camden, New Jersey
September 20, 1968

ADDENDUM B.

Opinion of the United States District Court District of New Jersey

(Filed Feb. 13, 1969)

Appearances:

JACK L. COHEN, Esq.
Attorney for the Receiver, James E. Masterson

RAVIN & RAVIN, Esqs.
By: NATHAN RAVIN, Esq.
Attorneys for Valley National Bank of Long Island

MULLOOLY, JEFFREY & ROONEY, Esqs.
(New York Bar)
By: BERNARD JEFFREY, Esq.
Of Counsel

COOLAHAN, District Judge:

This bankruptcy matter is before the court at the present time on a petition filed by the Valley National Bank of Long Island (New York) for review of an Order of the Referee in Bankruptcy holding that the Bankruptcy Court has jurisdiction to determine the merits of a Petition on Order to Show Cause filed by the Receiver to direct the Bank to turn over to him the sum of $85,000 allegedly appropriated by the Bank from the debtor without right to do so. In addition, the Receiver has moved to dismiss the petition for review, on the ground that it was improvidently filed in that it seeks to improperly review an interlocutory Order of the Bankruptcy Court.

The relationship between the Valley National Bank of Long Island and the debtor first came before the Bank-

ruptcy Court when the Bank filed with that court a proof of claim in the Chapter XI proceedings initiated by the debtor for the purpose of effecting a plan of arrangement. The proof of claim indicated that $5,628.67 was owed to the Bank by the debtor, which debt was secured by liens on two 1966 Cadillacs. Subsequently, the Receiver filed with the Bankruptcy Court a Petition on Order to Show Cause directed against the Bank, whereby he sought an order directing the Bank to turn over $85,000 which he alleged the Bank wrongly appropriated from the debtor's account with the Bank. The $85,000 matter had nothing whatsoever to do with the Bank's $5,628.67 claim. The Bank filed a special appearance with the Bankruptcy Court and alleged that that court lacked jurisdiction in the turnover proceeding over both the subject matter of the proceeding and the person of the Bank. It pointed out to the court that 12 U.S.C. §94 provides that a national bank such as the Valley National Bank can be sued only in a federal court where it is "established," or a state court where it is "located," and that it is located and established in Nassau County, New York. Rejecting the Bank's position, the Referee noted that a national bank can, under certain circumstances, waive the privilege against suit elsewhere than the place where it is established or located, and held, based on the recent United States Supreme Court decision in *Katchen v. Landy*, 382 U.S. 323 (1966), that the Bank's filing of a proof of claim in the present proceeding was in fact an instance of such waiver, and hence that the Bankruptcy Court had jurisdiction over the merits of the Petition on Order to Show cause filed by the Receiver. Because this court considers the Referee's interpretation of *Katchen v. Landy* to have been erroneous, and because it considers the Receiver's citation of the usual "final order" rule to be inappropriate in the circumstances of the present

case, the Referee's determination of the personal jurisdiction question will be reversed, and the Receiver's motion to dismiss the petition for review will be denied.

Prior to *Katchen v. Landy*, there was considerable doubt as to whether a Referee in Bankruptcy had jurisdiction over counterclaims interposed against creditors filing proofs of claims in bankruptcy proceedings. *Katchen*, *supra* at 326 n.1. In the Fifth Circuit, for example, it was uncertain whether a Referee had jurisdiction to entertain a Trustee's or Receiver's demand for surrender of a preference, even if that preference arose out of the same transaction as the creditor's claim.[1] At least one decision appeared to hold that under no circumstances could the Referee consider such a counterclaim. Other jurisdictions, including this one, had held that the Referee had jurisdiction over counterclaims arising out of the same transaction as the creditor's claim, but not over counterclaims arising out of different transactions. See *In re Solar Mfg. Corp.*, 200 F. 2d 327 (3d Cir. 1952), *cert. denied sub nom. Marine Midland Trust Co. v. McGirl*, 345 U.S. 940. On the other hand, the lower court decision in *Katchen*, 336 F. 2d 535 (10th Cir. 1964), stated by way of dictum that the Bankruptcy Court had jurisdiction over all counterclaims involving preferences, set-offs, voidable liens, or fraudulent transfers, whether or not they arose out of the same transaction as the creditor's claim, but held that counterclaims not involving preferences, set-offs, voidable liens, or fraudulent transfers must be related to the creditor's claim for the Referee to have jurisdiction. Since the counterclaim sought to be asserted

[1] There was no doubt, of course, but that the Receiver could object to the creditor's claim on the ground that it was an improper preference; the only question was whether he could affirmatively ask the Bankruptcy Court to compel the creditor to surrender the preference, or whether, on the other hand, the surrender of the preference had to be adjudicated in a separate action filed by the Receiver. *Katchen v. Landy*, *supra*.

in *Katchen* clearly involved a preference related to the creditor's principal claim, the direct holding of the lower court in *Katchen* was that the Bankruptcy Court had jurisdiction over counterclaims arising out of the same transaction as the creditor's claim.

Argument before the Supreme Court by the affected creditors in *Katchen* apparently revolved around the direct holding by the Court of Appeals and the creditor's assertion that even where the counterclaim sought to be interposed related to the principal creditor's claim the Bankruptcy Court could not entertain that counterclaim, as the Supreme Court opinion in *Katchen* directed itself only to establishing "that the Act does confer summary jurisdiction to compel a claimant to surrender preferences that under §57g would require disallowance of a claim," 382 U.S. at 335, *i.e.*, preferences related to the creditor's claim. Furthermore, the Supreme Court stated that:

> we obviously intimate no opinion concerning whether the referee has summary jurisdiction to adjudicate a demand by the trustee for affirmative relief, all of the substantial factual and legal bases for which have not been disposed of in passing on objections to the claim.

382 U.S. at 333 n.9, and that "'a number of Courts of Appeals, including the court below, have reached similar results [citing cases mentioned earlier, such as the Third Circuit opinion in the *Solar Mfg. Co.* case, which upheld Bankruptcy Court jurisdiction over related counterclaims].'" 333 U.S. at 335-36.

Ignoring the apparent gloss that the Supreme Court placed on the Tenth Circuit's decision in *Katchen*, when the Court characterized that decision as standing only for the proposition that counterclaims related to the principal creditor's claims could be entertained by the Bankruptcy

Court, it is eminently clear that the Court's decision did not at all decide whether an unrelated counterclaim can be considered by the Bankruptcy Court when sought to be interposed against a creditor's claim. In reaching that decision *Katchen* is of no help whatsoever. As a result, a decision in the present case, where the sole issue is whether an unrelated counterclaim can be adjudicated by the Referee,[2] can be reached only by an examination of existing law on that question; it is here that the Third Circuit's decision in the *Solar Mfg. Co.* case, *supra*, becomes dispositive. That 1952 case most clearly holds, along with the majority of cases in other Circuits having considered the question, that distinction must be made between related and unrelated counterclaims, and that unrelated counterclaims have no place whatsoever in the Bankruptcy Court. This being the case, and there being no question but that the counterclaim sought to be interposed here has nothing to do with the Bank's $5,628.67 claim against the debtor, the decision of the Referee upholding the jurisdiction of his court in the present matter will be reversed.[3]

Nor is there any merit to the Receiver's contention that, since the Referee's determination that the Bankruptcy Court had jurisdiction over the Bank was not a "final order," no decision having been made as to whether the Bank did in fact misappropriate $85,000 of the debtor's money, this court should not decide the jurisdictional question raised by the Bank's Certificate of Review. Although

[2] In fact, in the present case the Receiver has interposed no counterclaim; however, his activities by way of Order to Show Cause certainly can be treated as though they were a formal counterclaim.

[3] See also *In re Beasley-Gilberts, Inc.*, 285 F. Supp. 339 (S.D. Ohio 1968), a post-*Katchen* case which apparently saw nothing in the Supreme Court's opinion in *Katchen* which would disturb the pre-*Katchen* dichotomy between related and unrelated counterclaims.

it is true that in general it is appropriate that only "final orders" of the Bankruptcy Court be reviewed. *In re Prindible*, 115 F. 2d 21 (3d Cir. 1940), it is also true that the rule enunciated in *Prindible* is not jurisdictional, as is pointed out by the fact that a leading basis for *Prindible*, *In re Reukauff Sons & Co.*, 135 F. 251 (E.D. Pa. 1905), states that the rules permitting review of Bankruptcy Court's decisions:

> contemplate that there shall be a contested matter, a finding or an order, and a party aggrieved, and I see no indication anywhere that the judge may be required to answer questions before the referee himself takes action. *An exceptional case might perhaps cal for such instructions*, but certainly in the ordinary proceeding the referee must make some order or ruling before there is anything to certify. (Emphasis added).

135 F. at 252. See also *Sulmeyer v. Pfohlman*, 329 F. 2d 915 (9th Cir. 1964); W. Collier, Bankruptcy ¶39.21, at 1503-04 (14th ed. 1968). Although the present case is certainly dissimilar from *Reukaff*, in that there has been an "order or ruling" by the Referee (this dissimilarity being favorable to the Bank's position here, one might add), this court considers the circumstances of the present case, exemplified by the fact that there has been what the court views as certain error by the Bankruptcy Court in an area of obvious congressional concern (national banking), to be sufficiently "exceptional" for it to disregard the ordinary "final order" rule.

This being the case, the decision of the bankruptcy Referee will be reversed, and the motion of the Receiver to dismiss the Bank's Certificate of Review will be denied.

Let an appropriate order be submitted.

ADDENDUM C

Opinion of United States Court of Appeals For the Third Circuit

(Filed April 10, 1970)

Argued December 19, 1969

Before McLAUGHLIN, FREEDMAN and ADAMS, *Circuit Judges*

McLAUGHLIN, *Circuit Judge*

This is an appeal by the Receiver from an order of the United States District Court for the District of New Jersey holding that the Bankruptcy Court did not have jurisdiction over the matter now before us.

In May 1967, the debtor, Carnell Construction Corp., a new York corporation, filed in the New Jersey District for a Chapter XI arraignment with its creditors. At the time of filing, appellee Valley National Bank of Long Island, New York, held a security interest in two automobiles owned by and in the possession of said debtor. The Bank subsequently filed a proof of claim with the Bankruptcy Court, asserting that there was a balance due it from the debtor on the automobiles totalling $5,628.67. In addition to that automobile financing, and also prior to the filing of the Chapter XI proceeding, Carnell had owed Valley National Bank $85,000 on an outstanding loan and the Bank had applied the amount of that loan in payment thereof from Carnell's deposit with it. Thereafter, in the New Jersey District bankruptcy, the Receiver, alleging the Bank had no right to use the $85,000 to satisfy its loan to Carnell, sought a turnover order to compel the Bank to turn over to him the said sum of $85,000. The Bank entered a special appearance urging that the Bankruptcy Court lacked both in personam and subject matter jurisdiction. The Referee

concluded that such jurisdiction existed. The Bank brought the issue to the District Court by petition for review. That tribunal held that the Bankruptcy Court had no jurisdiction over the admittedly unrelated claim of the Receiver and reversed the conclusion of the Bankruptcy Court. As stated the Receiver appeals from that ruling.

The issue before us is simply whether—because of the Bank's filing of a proof of claim concerning its security interests in the two automobiles it had financed for the debtor—the Bankruptcy Court has summary jurisdiction to determine the Receiver's completely unrelated claim to the $85,000. Appellant does *not* contest the District Court's conclusion that "The $85,000 matter had nothing whatsoever to do with the Bank's $5,628.67 claim (arising from the automobile financing transaction.)" In the Matter of Carnell Construction Corp. No. B-789-67 (D. N.J., May 13, 1969).

Appellant's main argument is that the court below, in effect, misconstrued *Katchen v. Landy*, 382 U.S. 323 (1966), and that in *Katchen* the Supreme Court has already decided the problem now before use adversely to appellee. We disagree.

Katchen stands for the proposition that a bankruptcy court has summary jurisdiction to affirmatively order a claimant to surrender voidable preferences. The Bank was of course subject to a proper counterclaim by the Receiver. *Alexander v. Hillman*, 296 U.S. 222 (1935). Further, *Katchen* has made it clear that where bankruptcy jurisdiction is indicated, a claimant's jury trial right (which might obtain in a plenary proceeding) is subordinated to the statutory scheme of the Bankruptcy Court and its summary jurisdiction. Hence, the warning in *Gill v. Phillips*, 337 F. 2d 258, 262 (5 Cir. 1964) that "° ° ° consent to summary jurisdiction is not to be lightly inferred" is sound. As

the court wrote *In Re Beasley-Gilberts, Inc.*, 285 F. Supp. 359, 361 (S.D. Ohio, 1968):

> "It is settled that a creditor who proves a claim submits himself to the summary jurisdiction of the Bankruptcy Court in respect of preferences or voidable transfers, including the jurisdiction of the Bankruptcy Court to enter a monetary judgment or order a return. *Katchen v. Landy, supra.* It also appears to be fairly well settled that a creditor who files his claim in the Bankruptcy Court impliedly consents to be sued on counterclaims arising out of the same transaction, but that such a filing does not constitute implied consent to be sued on an alleged cause of action arising out of a different matter."

Examination of the background of *Katchen* completely affirms the District Court's conclusion that *Katchen* did not alter the law as to a Bankruptcy Court's summary jurisdiction over counterclaims not related to the creditor's claim. In the Court of Appeals, *Katchen v. Landy*, 336 F. 2d 535 (10 Cir. 1964), four counterclaims were involved; three concerning voidable preferences, and one unrelated counterclaim grounded on an allegation that the claimant owed the bankrupt corporation money on unpaid subscribed organization stock. The Court of Appeals affirmed the finding of jurisdiction over the related counterclaims, but reversed as to the unrelated counterclaim. The sole question before the Supreme Court dealt with the question as to the related counterclaims over which the determination of jurisdiction had been affirmed by the Court of Appeals. And it was this holding that the Court affirmed. In fact, the Court (citing in re Solar Mfg. Corp., 200 F. 2d 327 (3 Cir. 1952), cert. denied sub nom. Marine Midland Trust Co. v. McGirl, 345 U.S. 940), "* * * have stated that * * * (a bankruptcy's court summary) jurisdiction does not extend to permissive counterclaims arising out of distinct transactions."

It is clear then that the court below was correct in ruling that our previous decision in *Solar*, *supra*, controls this case, and that in this Circuit a Bankruptcy Court does not have jurisdiction over a counterclaim interposed by a Receiver which is unrelated to the creditor's claims. Since, as we mentioned, it is not disputed that the Receiver's "counterclaim" for the $85,000 is unconnected to the Bank's proof of claims concerning its security in the automobiles, *Solar* is dispositive.

In addition to the above outlined cogent reason for upholding the order of the District Court it is obvious that the Bank's set-off of Carnell's deposit to the amount of Carnell's indebtedness to the Bank was not a preference since under Section 68 of the Bankruptcy Act as construed by the decisional law the Bank had the right to make the set-off. See 4 Collier on Bankruptcy, §68.16(2) (4th ed. 1969).

The order of the District Court will be affirmed.

A True Copy:

Teste:

Clerk of the United States Court of Appeals for the Third Circuit.

ADDENDUM D

Judgment of the United States Court of Appeals For the Third Circuit
(Filed April 11, 1970)

This cause came on to be heard on the record from the United States District Court for the District of New Jersey and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court, filed May 9, 1969 be, and the same is hereby affirmed, with costs taxed in favor of appellee.

ATTEST:
THOMAS F. QUINN
Clerk

April 10, 1970

IN THE

Supreme Court of the United States

October Term, 1970

No. 373

In the Matter of

CARNELL CONSTRUCTION CORP., a corporation of the State of New York, authorized to do business in the State of New Jersey

JAMES E. MASTERSON,
Receiver-Petitioner,

vs.

VALLEY NATIONAL BANK OF LONG ISLAND,
Respondent.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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On the Brief

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Vital Conceded Fact

For all purposes herein and before presenting the issues, it is conceded that the subject matter of the Receiver's petition is totally foreign and unrelated to the subject matter of the secured proof of debt filed by Respondent, *infra.*

Questions Presented

1. Did the Bankruptcy Court for the District of New Jersey, in a Chapter XI proceeding, acquire summary jurisdiction over Respondent, a national bank with a head office located in Nassau County, State of New York, to make a summary affirmative order on the receiver's separate, independent, turnover petition solely and only by reason of the filing by Respondent of a secured proof of debt on two Cadillac cars not in the possession of Respondent?

2. Should this court accept jurisdiction on a purely procedural step not affecting the substantive rights of the Receiver when the Receiver had and still has an absolute right, be he so advised, to commence a plenary action for that which he seeks summarily in the county wherein Respondent bank maintains its head office (12 U.S.C. 94)?

Counterstatement of Facts

A counterstatement of the facts is felt to be necessary for a proper determination on this petition for certiorari.

The statement of case contained at page 3 of the Receiver's petition is totally inadequate.

(a) Respondent is a national bank having its head office located in Nassau County, State of New York, within the federal jurisdiction of the United States District Court, Eastern District of New York.

(b) All of the transactions of and concerning the subject matter of the secured proof of debt and of the Receiver's subsequent turnover petition and all of the witnesses involved thereon are situated within Nassau County, except for the Receiver and his counsel. They alone are from New Jersey.

(c) On March 28, 1968 Respondent filed with the Bankruptcy Referee a secured proof of debt covering two Cadillac cars. Neither car was in the bank's possession. Respondent, however, had, more than four months prior thereto, perfected its security interest therein by virtue of the due filing of financing statements with the Clerk of the County of Nassau and with the Secretary of State of the State of New York pursuant to UCC 9-401 (1)(c).

(d) Some two months thereafter, on May 21, 1968, the Receiver by order to show cause and petition moved for a summary turnover order of certain monies which Respondent previously set-off as against the amount of Carnell's indebtedness to the bank.

(e) It is conceded that the set-off and the facts bottoming it had nothing whatever to do and was completely foreign and totally unrelated to the subject matter of the secured proof of debt.

(f) The Receiver neither served nor filed any Bankruptcy Act 57 (g) objection (or any objection for that matter) to the secured proof of debt.

(g) Respondent then filed a special appearance and moved to dismiss the petition of the Receiver on the grounds that the Bankruptcy Court lacked summary jurisdiction over this New York based national bank.

Dispositions Leading up to This Petition

1. The Bankruptcy Referee on September 20, 1968, dismissed the special appearance and denied Respondent's motion to dismiss the Receiver's petition holding that *Katchen* v. *Landy*, 382 U.S. 323, 86 Sup. Ct. 467, was dispositive notwithstanding that the subject matter of the petition was totally unrelated to the subject matter of the secured proof of debt and notwithstanding that Respondent never consented, expressly, by implication, or by waiver to be sued other than within the County or the Federal District wherein its head office is located.

2. The District Court of New Jersey (Hon. JAMES A. COOLAHAN, Judge) on petition for review, reversed the Bankruptcy Referee, holding that *Katchen* v. *Landy*, *supra*, was not dispositive of the facts in this case involving an unrelated counterclaim; that in such a situation, the court would not obtain summary jurisdiction; the effect of the court's decision was that it would not extend the vitiation of Respondent's right to be sued in a plenary action with the attendant rights of jury trial and disclosure; nor, would the District Court by judicial fiat nullify the Respondent's statutory rights under 12 U.S.C. 94.

3. The Court of Appeals for the Third Circuit by decision filed April 10, 1970 and judgment entered April 11, 1970, affirmed the order of the District Court.

Reasons for Denial of the Writ

1. The decision of the Court of Appeals is not in conflict with *Katchen* v. *Landy, supra.*

At the outset it should be noted that Respondent has urged in all courts below that it had the right afforded it venuewise in 12 U.S.C. 94 and that this right was never waived. Neither the District Court nor the Court of Appeals found it necessary, however, to reach this point.

Moreover, it was pointed out by Respondent in each court below that the Receiver was not without relief. For under 11 U.S.C. Sec. 46(b) (Bankruptcy Act Sec. 23(b)), the Receiver could bring an action wherein the bankrupt (or debtor in possession) might have brought or prosecuted such an action and such court is jurisdictionally limited to the county wherein the head office of the national bank is located (12 U.S.C. 94).

The history leading up to *Katchen* clearly supports the views of Judge COOLAHAN and of the Circuit Court as expressed in their opinions.

Prior to *Katchen,* the law had been that a creditor's claim for allowance could be successfully defensed by the assertion of a 57 (g) objection on a related counterclaim.*

* It is to be noted that no question exists as to allowance of Respondent's secured proof of debt. Respondent being secured, the proceeding being under Chapter XI, Respondent's claim to the vehicles was not involved. Respondent therefore never sought allowance and 57 (g) had no application. This brief, however, is submitted under the *arguendo* assumption that it did. It is likewise assumed *arguendo* only that the Receiver's petition alleged a preferential claim; a fact found to be otherwise by the Circuit Court.

In litigating the issue of allowability, it was perforce necessary to determine the question of a preference and if so, the amount thereof. For before allowing a related claim, the preferential claim by statute (57 (g)) would have to be surrendered.

The problem which vexed the Circuits and led up to *Katchen* was whether in addition to disallowance under 57 (g) the Bankruptcy Court could advance the final step and summarily make an affirmative order granting the Trustee his relief on the related preference or relegate the Trustee to bringing a plenary action for this affirmative relief.

Res judicata and collateral estoppel were the two cogent reasons why affirmative relief should be allowed along with disallowance as one complete step. The issue of preference being necessarily determined as part of the allowance process and all parties being before the court, it became an exercise in futility and slavery as to form over substance to require the Trustee to bring a subsequent plenary suit with the plenary courts' hands tied by *res judicata* and collateral estoppel.

Undoubtedly, however, the Circuits approached the paradox circumspectly and warily, having in mind the repugnant *in terrorem* nature of 57 (g).

However, in weighing and balancing the equities, it was felt that where the counterclaim is related, the *in terrorem* repugnancy is overcome and the creditor seeking an allowance of a related claim could not be heard to contest a summary disposition on a counterclaim related to it. This

would follow public policy as expressed in the entire scheme of the Bankruptcy Act.

With the foregoing in mind, we approach *Katchen* v. *Landy, supra.*

In *Katchen*, the corporate bankrupt borrowed $50,000 from two local banks. Katchen as principal officer of the corporation was accommodation maker of notes delivered to the banks. After a disastrous fire, funds of the corporation were placed in a "trust account" under his sole control. From this account, he made two payments on one of the corporate notes and one on another.

Katchen filed two general claims seeking an allowance for rent due and for payment on one note from personal funds. The Trustee in each of three counterclaims asserted that the three payments made to Katchen from the "trust account" were voidable preferences, should be disallowed and in addition demanded affirmative relief. These three counterclaims were directly related to Katchen's claim for allowance. In addition, the Trustee counterclaimed for the amount due on a stock subscription. The first three counterclaims were preferential and related. The fourth was neither.

The Referee upheld jurisdiction on all four. The District Court on review affirmed jurisdiction on all four. The Court of Appeals affirmed except on the unrelated fourth counterclaim. On this it reversed. The Circuit Court held summary jurisdiction did not lie on the fourth unrelated counterclaim. Certiorari was never sought as to the fourth

unrelated counterclaim. Thus *Katchen* v. *Landy's* disposition thereof in the Circuit Court dismissing same has been permitted to stand.

In effect then, *Katchen* stands for the proposition that where the counterclaim alleges preference and is related a filed claim seeking its allowance confers summary jurisdiction—this and nothing more.

The main thrust of the Petitioner in *Katchen* v. *Landy* in the Supreme Court was that if Katchen did not file a claim for allowance and awaited the Trustee's onslaught, it would have to be plenary. There Katchen reasoned (not without logic) he would be entitled to a jury. Why should he be so barred he asks because he moved first by filing a claim? While not couched in so many words, in effect he was urging the *in terrorem* argument. This court, however, held otherwise in affirming the Circuit Court.

The foregoing analysis clearly upholds Judge Coolahan's expressed view in the District Court in the instant case:

> "* * * that distinction must be made between related and unrelated counterclaims, and that unrelated counterclaims have no place whatsoever in the Bankruptcy Court."

Thus, Mr. Justice White, speaking for the Supreme Court, in *Katchen*, resolved the issue as to related counterclaims explicitly. The issue on the unrelated counterclaim was resolved in the Tenth Circuit in the Court of Appeals as this was never appealed.

Mr. Justice WHITE expressed the issue in the *Katchen* case to be:

> "* * * whether a bankruptcy court has summary jurisdiction to order the surrender of voidable preferences asserted and proved by the trustee in response to a claim filed by the creditor who received the preference" (page 325) [where the counterclaims in response are related and where the claim is filed for allowance]

As stated by the learned Justice at page 326:

> "The crux of the dispute here concerns the mode of procedure for trying out the preference" * * *.

The diversity theretofore existing between the Circuits was then laid to rest. It no longer existed or exists. *Katchen* v. *Landy* finally determined that where a creditor seeks allowance of his claim and a related counterclaim is interposed as part and parcel of the allowance process, the Referee may make an affirmative order with respect to the preference.

The paradox of *res judicata* was thus overcome and a meaningless plenary action over an issue already judicially determined obviated.

Where, however, the counterclaim is unrelated, the *in terrorem* argument stands, and the claimant's constitutional rights on a totally unrelated claim will not be destroyed. Nor will he by threat of forfeiture of a claim be barred from asserting in the proceeding a just claim.

The law on unrelated counterclaims remains as it has always been. The courts will not summarily entertain them.

It is respectfully submitted that there is no conflict between the Circuits nor has the decision of the Court of Appeals in the court below conflicted with this court's interpretation of 57 (g) as found in *Katchen* v. *Landy*.

2. The questions presented are not of sufficient importance to require adjudication by this court.

Respondent did not have possession of the vehicles. Filing of the financing statements took place in the State of New York. The Chapter XI proceeding took place in the State of New Jersey.

There would be no way absent notification for the Receiver or the Bankruptcy Court to have notice of Respondent's security interest without some advice from Respondent. This advice took the form of the filing with the Bankruptcy Referee of the secured proof of debt not for the purpose of having the bank's claim allowed but rather to put the Receiver and the court on notice as to Respondent's security interest in the two vehicles and to thereby protect such security.

It would be a shameful abuse of the Respondent's actions to permit the Receiver to convert the foregoing into a jurisdictional trap from which extrication could be brought about only upon a forfeiture of constitutional rights.

As stated by the late Mr. Justice Cardozo when he sat on the New York State Court of Appeals:

> "The law has outgrown its primitive stage of formalism when the precise word was the sovereign talis-

man, and every slip was fatal. It takes a broader view today." (*Wood* v. *Lucy, Lady Duff-Gordon*, 222 N.Y. 88, 91; 118 N.E. 214.)

The writer has put it somewhat more picturesquely and bluntly albeit perhaps inelegantly in his brief in the Court of Appeals. It was there urged that it was grossly insulting and manifestly repugnant to the courts to apply a flypaper theory of jurisdiction. That it was unseemly to attempt to stick unsuspecting secured claimants who filed their secured claims in good faith but by chance thereby brush the flypaper and find themselves facing an unrelated counterclaim in a foreign jurisdiction in a summary manner stripped of ancient rights dating to Runnymede in 1215.

Such is the net effect of the Receiver's argument.

That the questions presented are not of sufficient importance for this high court to accept the case is emphasized by the fact that no one loses rights by such refusal.

The Receiver is completely free to do what he could always do if he be so advised: commence a plenary action in the New York State Supreme Court in Nassau County or in the United States District Court, Eastern District of New York.

This case does not, in any sense, involve any broad new legal principles that have application beyond the scope of the fact pattern in this particular case nor is there any important question of constitutional law in the posture in which it comes before this high court.

CONCLUSION

The judgment below should be sustained in all respects and the petition for a writ of certiorari should be denied.

Respectfully submitted,

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